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Nicole Eshnaur • Mar. 19, 2018

As soon as a business hires its first employee, the challenges of payroll management begin. The technicalities and need for vigilance increase exponentially as the company grows and its workforce expands. Even if it downsizes staff and turns more toward independent contractors, considerable payroll-related issues should be considered.

What's a business owner to do? To stay apprised of payroll management's risks to the ongoing stability of your company, they should keep an eye on the following four fundamentals. Succeed in these spheres and they will stand a better chance of heading off mistakes or oversights before they turn into major crises.

1. Understand the process

Many businesses outsource their payroll functions to their accounting firm or

It's also a good idea to monitor the payroll tax account to verify funds are being deposited in a timely fashion and in accurate amounts. If using electronic deposits, the federal government's EFTPS website (https://www.eftps.gov/eftps) can help keep an eye on the account's activities.

2. Know what's taxable

Another fundamental to guarding against payroll risk is simply knowing what's taxable and what's not — and keeping up with these items from year to year. So, what *is* taxable? "Wages" of course, but the law defines this word broadly to include many types of compensation, including full- and part-time salaries, hourly wages, fees, bonuses, and commissions.

It's also helpful to look into what's generally *not* subject to payroll taxes under the Internal Revenue Code. Some non-cash compensation may be deemed a "statutorily excluded" (or "fringe") benefit and, therefore, excluded from employee income.

Examples include group term-life insurance (up to certain limits), some health care coverage and parking privileges. In fact, one potential way to ease your payroll tax burden is to compensate employees partially in the form of such benefits rather than wages.

Another way to reduce the payroll tax burden is to create an accountable plan to reimburse employees for the costs of travel, entertainment, tools or other eligible business-related expenses.

As long as the plan meets IRS standards to qualify for tax-advantaged treatment, the business won't have to pay employment taxes on the reimbursements, and employees won't have to pay income taxes or their portion of employment taxes on them, either. Plus, you can deduct the reimbursements as a business expense.

3. Classify employees properly

employee — not an independent contractor. In such cases, the business must issue the worker a Form W-2 and withhold and pay the appropriate payroll taxes. This pertains to both full- and part-time employees as well as seasonal workers.

If the IRS reclassifies an independent contractor as an employee, the business may face back taxes, interest, and even penalties. So businesses need to carefully track the engagement, progress and project completion of each independent contractor. It's risky having one of these individuals performing services for you indefinitely.

Moreover, double-check that no managers or employees are issuing orders to a contract-based worker. Independent contractors should be, among other factors, largely free to completely control what they do and how they do it. They also need to pay self-employment taxes and incur a financial risk by working for the company. The business should keep a Form W-9 on file for these independent contractors and issue Form 1099 at year-end for payments made to them.

4. Maintain sound records

Employers must retain thorough payroll records for a variety of reasons. Applicable documentation includes hiring records (such as Forms W-4 and I-9) and ongoing employment records (such as time sheets, expense reports, and Forms W-2). Although not directly related to payroll administration, documents related to each employee's performance reviews, disciplinary actions and terminations should also be retained.

Once again, even if the business outsources its payroll functions, maintaining a high visibility level of the payroll records is critical. It's also a good idea to periodically perform an internal audit of these records to ensure they're in optimal shape. The worst time to learn about lost or mishandled payroll documentation is after a lawsuit has been filed or an IRS agent is at the door.

Respecting the complexity

Nicole Eshnaur, CPA, CGMA, MBA, is a practice leader with Marks Nelson CPA.

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